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UNCLAS SECTION 01 OF 03 KUALA LUMPUR 000398

SIPDIS

TREASURY FOR BELL AND WEISEL
SINGAPORE FOR BAKER

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TAGS: ECON EPET EFIN ENRG MY PGOV
SUBJECT: MALAYSIAN OIL REVENUE: GRAVY TRAIN RUNNING OUT OF
TRACK

REF: KUALA LUMPUR 173

¶1. (U) Summary: At its current 4% annual rate of increase, domestic demand for petroleum products is expected to overtake supply by 2011 or 2012, making Malaysia a net importer of oil, according to Petronas, the country's national oil company. This bodes poorly for a federal government that relies on its national oil company for nearly 40% of its revenue. Petronas' response is to continue to expand its operations globally. The Government of Malaysia hopes to address this challenge by gradually reducing its crippling fuel subsidies that cost USD 14 billion dollars a year and perversely undermine efforts to increase efficiency, reduce consumption, and develop alternative sources of energy. Few oil and gas insiders, and fewer among the general public, seem aware that the gravy train of oil exports is quickly reaching the end of its track. However, a local technology company has developed a promising system that could reduce fiscal outlays by limiting fuel subsidies to low-income citizens, using existing national electronic identity cards that all Malaysians are required to carry. This could be the most palatable solution for the general public and save the government from a pending fiscal fiasco. End summary.

PETRONAS' PRODUCTION FORECASTS

¶2. (U) At a recent conference Petronas Vice President for Corporate Development Mr. Nasarudin Idris provided an overview of Malaysian oil production. Malaysia has 5.36 billion barrels of proven reserves which are expected to last approximately 16 years. However, Malaysian oil fields are maturing, and output is declining. Production peaked at 750,200 barrels per day (bbl/day) in 2004, then dropped to 735,700 bbl/day in 2005, to 699,100 in 2006, and further to 661,100 bbl/day in 2007. Production declined in 2007 even with the addition of the Kikeh Field, a joint venture between Murphy Oil and Petronas and Maysia's first deepwater operation, which came online in August.

¶3. (U) In order to achieve the government's goal of maintaining production at 700,000 bbl/day, Malaysia would have to continue its exploration efforts and develop new and more challenging fields, Nasarudin explained. New sources of oil were being discovered, but in deeper waters and in more challenging fields with high pressure, high temperatures, and high CO2 levels. Petronas also was working to increase recovery rates in existing fields, looking outside of Malaysia, and continuing to develop its technology and capabilities. To maintain production, Petronas would need to plow earnings back into exploration and development, he said. He also noted that in 1997 Petronas' contribution to federal

coffers amounted to 15% of the government's revenue; today, it amounts to nearly 40%.

¶4. (U) In a meeting with Robert Manning, Director of Energy, U.S. National Intelligence Council and ECONOFF on April 25 Mr. Muhamed Firouz Asnan, General Manager of Petronas' Business Development Unit Mr. Khairil Anuar Ramili, Manager of Group Strategic Planning confirmed Petronas' earlier announcements that Malayia was on track to become a net importer by 2011 or 2012, given current trends in domestic demand which are increasing by 4 to 5 percent annually. These calculations included the new deepwater fields and plans to increase recovery rates, they said. Murphy Oil's new Kikeh Field is expected to reach 120,000 bbl/day by the end of 2008, they said, and the joint Petronas-Shell deepwater operation at Gumusut Field is expected to come online in 2012. Meanwhile, ExxonMobil is planning to upgrade its equipment to maximize recovery rates in its mature fields off the east coast of Peninsular Malaysia (reftel). These factors are expected to offset declining production in Malaysia's mature fields, leaving production largely flat over the next decade, according to Firouz. When domestic demand overtakes supply, as is expected in the next three to four years, Malaysia will become a net importer of oil.

CONSTRAINTS ON PRODUCTION

¶5. (U) Mr. Ngau Boon Keat, a co-founder of Petronas who now runs Dialog Group Berhad, a local technology company, said that the seismic data from Malaysia's shallow waters was from the 1960s and 1970s. Ngau confirmed that Malaysia's fields were in the decline phase, but he felt that if Petronas were to re-survey with modern technology, they likely would make

new discoveries which could boost production. The main constraint, according to Ngau, was a lack of human resources. Oil companies operating in the Middle East were offering much higher salaries to anyone with experience in the energy sector, as much as four times what they earned in Malaysia. Because Petronas was a national oil company, large salary increases would have to be approved by the government; however, civil servants were unwilling to approve large salary increases well over what they themselves were earning.

¶6. (U) The shortage of human resources, especially with the salaries being offered in the Middle East, is a common refrain from executives from Murphy Oil, Petronas, and others in the industry. Murphy executives point out that a lack of capacity is another major constraint in this capital intensive sector. With the price of oil soaring, every available piece of equipment is being used, but with future prices unknown, building more equipment becomes risky. It can take several years and millions of dollars to build additional equipment and infrastructure. Commitments made based on today's prices might not be profitable by the time they come online if prices fall. Several industry experts expected oil prices to fall, saying the current price of more than $120 dollars per barrel was inflated by speculators, not a realistic indication of demand and supply. One industry expert, Mr. V.V. Nathan of Deleum Berhad, a local energy services company, speculated that prices would fall to as low as USD 60 per barrel. Others were more reluctant to cite figures.

MALAYSIAN DOMESTIC DEMAND BOOSTED BY SUBSIDIES

¶7. (U) Reducing petroleum subsidies has been on the GOM agenda for some time. A price increase at the pumps in early 2006 drew public protests. Reducing subsidies is highly unpopular even in the best of times, but under the current climate of political uncertainty the task is even more difficult. In the run-up to the March 8 election this year there was much speculation that the GOM would raise gasoline prices, most likely by 30 to 40 sen (ten to thirteen cents)

per liter as soon as the election was over. Some opposition candidates cried foul, saying that as a net exporter of oil Malaysia should be increasing its subsidies because the oil rightfully belonged to the people, and that the poor would be worst hit by such a move. When election results handed record gains to the opposition the GOM had to think of other ways to cut its subsidy bill without further alienating voters.

¶8. (U) One proposal was to increase the price of high octane fuel required in high-performance vehicles. The likely impact of such a move on the GOM's subsidy bill would be negligible. It also would not address the problem of "smuggling," an issue getting more attention recently. The GOM claims that many fishermen don't bother to fish anymore because they make bigger profits by gassing up their boats in Malaysia and selling the subsidized fuel in Thailand, the Philippines, or Singapore at market prices. Singaporeans are much maligned for driving across the bridge only to fill their tanks with subsidized Malaysian gasoline and then drive back. By drawing attention to these small-time opportunists, the GOM is raising public awareness about the need to cut subsidies.

¶9. (U) Ngau Boon Keat's firm Dialog Group worked with ConocoPhillips to develop a system that would provide limited subsidies to low-income Malaysian citizens. Customers would pay market prices at the pump, but could swipe their national electronic identity cards, the "MyKad" which every Malaysian is required to carry at all times, through a card reader at the gas station. The MyKad would transmit the purchase information back to the government's Economic Planning Unit which maintains a database of financial information on every taxpayer. Low-income taxpayers would be eligible for a refund of part of the purchase price, up to a certain number of liters per month. Refunds would be transmitted electronically to the taxpayer's bank account or, if the taxpayer has no bank account, the EPU would establish one on his or her behalf. Everything would be done automatically. Ngau plans to unveil the system at a conference on information technology on May 18. The GOM could save as much as 50 percent of the GOM petroleum subsidy bill, says Ngau, if they approve it. Also, its use could be expanded to other products the GOM subsidizes as well. (Note: Approximately

30% of the products in the consumer price index basket are subsidized.)

GETTING THE MESSAGE OUT -- OR NOT

¶10. (SBU) In spite of Petronas' public efforts to set the record straight on Malaysian oil production, most Malaysians take a complaisant view. Several industry insiders as well as the CEO of the Malaysian Energy Center, a local energy think tank, told ECONOFF that Malaysia would remain a net exporter of oil for 15 years or more, apparently confusing total reserves with net exports. When questioned further about production, demand, and remaining reserves, even the think tank CEO deferred to Petronas. The GOM is beginning to ring the alarm bells to some extent by announcing that it expects to spend RM 45 billion (USD 14 billion) on fuel subsidies this year, more than its development budget. In order to generate the momentum for a significant subsidy cut, though, it will have to do a better job getting the message out.

KEITH